No. 85-1480

Supreme Court, U.S.
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In the Supreme Court of the United States

OCTOBER TERM, 1985

UNITED STATES OF AMERICA, PETITIONER

v.

MERCHANTS NATIONAL BANK OF MOBILE

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE ELEVENTH CIRCUIT

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QUESTION PRESENTED

Section 3505 of the Internal Revenue Code provides that, where a lender furnishes funds directly or indirectly to an employer for the payment of wages, the lender in certain circumstances may be personally liable if the required employment taxes are not withheld from those wages and paid over to the IRS. The question presented is whether, as a prerequisite to the government's maintenance of a civil suit to collect the lender's personal liability in such circumstances, the IRS must have sent to the lender, within 60 days of making an assessment of the unpaid taxes against the employer, a copy of the tax bill that is required to be sent to the employer under Section 6303(a).

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v.

MERCHANTS NATIONAL BANK OF MOBILE

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE ELEVENTH CIRCUIT

The Solicitor General, on behalf of the United States, petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Eleventh Circuit in this case.

OPINIONS BELOW

The opinion of the court of appeals (App., *infra,* 1a-4a) is reported at 772 F.2d 1522. The opinion of the district court (App., *infra*, 5a-9a) is unreported.

JURISDICTION

The judgment of the court of appeals (App., *infra*, 10a-11a) was entered on October 7, 1985. On December 16, 1985, Justice Powell extended the time within which to file a petition for a writ of certiorari to and including March 6, 1986. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATUTES INVOLVED

Sections 3505 and 6303 of the Internal Revenue Code of 1954 (26 U.S.C.) are set out in a statutory appendix (App., *infra*, 13a-14a).

STATEMENT

1. On November 9, 1977, the Commissioner made an assessment of unpaid employment taxes against Dri-Mix Products, Inc., for the third quarter of 1977 (App., *infra*, 6a). This assessment was in the amount of approximately $212,000 (R. 2). The assessment reflected Dri-Mix's liability for its own share of the applicable payroll taxes, as well as its liability for the income and social security taxes that it was required to withhold from its employees' wages and pay over to the IRS, but which it either did not withhold or did not pay over. On May 15, 1978, the Commissioner made a similar assessment against Dri-Mix, in the amount of approximately $184,000, for the fourth quarter of 1977 (App., *infra*, 6a; R. 2).

Section 6303(a) of the Internal Revenue Code[1] provides that the Commissioner, as soon as practicable after making a tax assessment, and in any event within 60 days of making an assessment, must "give notice to each person liable for the unpaid tax, stating the amount and demanding payment thereof." The Commissioner typically provides such notice by sending the taxpayer a "Request for Payment of Balance Due"—in essence, a tax bill—notifying the taxpayer of the amount owed and requesting payment within 10 days. See M. Saltzman, *IRS Practice and Procedure* ¶ 14.03, at 14-11 *et seq.* (1981). On the same day that the Commissioner made each of the above-described assessments against Dri-Mix, he sent Dri-Mix a notice pursuant to Section 6303(a) stating the amount of its unpaid employment taxes and demanding payment thereof (App., *infra*, 6a). In each instance, Dri-Mix failed to pay, in whole or in part, the taxes thus assessed (R. 3).

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[1] Unless otherwise noted, all statutory references are to the Internal Revenue Code of 1954 (26 U.S.C.), as amended (the Code or I.R.C.).

2. On March 18, 1983, the United States brought this action in the United States District Court for the Southern District of Alabama against respondent, a bank with its principal place of business in Mobile, Alabama (App., *infra*, 1a, 5a; R. 1-2). The government's complaint alleged that respondent, beginning in January 1977, had lent funds to Dri-Mix under circumstances that rendered respondent personally liable, under Section 3505 of the Code, for a portion of Dri-Mix's unpaid employment taxes (App., *infra*, 2a, 6a; R. 3). Specifically, the complaint alleged (R. 3) that respondent had "pa[id] wages directly to [the] employees" of Dri-Mix, in consequence of which respondent under Section 3505(a) became "liable in [its] own person and estate to the United States in a sum equal to the taxes (together with interest) required to be deducted and withheld from such wages" (I.R.C. § 3505(a)). The complaint further alleged (R. 3) that respondent had supplied funds to Dri-Mix "for the specific purpose of paying wages," with knowledge that Dri-Mix did not intend, or would not be able, "to make timely payment or deposit of the [taxes] required * * * to be deducted and withheld" from its employees' wages, in consequence of which the bank had incurred personal liability under Section 3505(b). The government's complaint alleged that respondent's total liability under Section 3505 for the third and fourth quarters of 1977 was approximately $220,000, plus interest (R. 3-4). This sum roughly corresponded to the portion of the overall assessment against Dri-Mix that was for unpaid withholding taxes, as opposed to Dri-Mix's own share of the payroll tax.

By way of amended answer, respondent asserted as an affirmative defense that the government was precluded from suing it because it had not been notified of the assessment against Dri-Mix within the 60-day period specified in Section 6303(a). See App., *infra*, 2a; R. 354-356. Respondent submitted that, if the instant suit were

successful, it would be a "person liable for the unpaid tax" (I.R.C. § 6303(a)). Respondent accordingly argued that the Commissioner was required, within 60 days of making the assessments against Dri-Mix, to send respondent as well as Dri-Mix a notice "stating the amount [of the unpaid tax] and demanding payment thereof" (*ibid.*). Respondent further contended that the Commissioner's failure to give it timely notice of the assessment against Dri-Mix erected an absolute bar to the instant suit, and it moved for summary judgment on that basis. App., *infra*, 2a, 6a; R. 358-361.

The district court granted respondent's motion for summary judgment and ordered the government's suit "dismissed with prejudice" (App., *infra*, 12a). Relying on *United States* v. *Associates Commercial Corp.*, 721 F.2d 1094 (7th Cir. 1983), the district court held that Section 6303(a) requires the IRS to give notice " 'to lenders allegedly subject to * * * liability' " under Section 3505, thus " 'alerting [them] to a possible civil action' " (App., *infra*, 8a & n.1 (quoting 721 F.2d at 1099 & n.10)). The court found that the IRS had not given respondent written notice of the assessments against Dri-Mix within 60 days of making either assessment, and it concluded that the Commissioner's "failure * * * to give the required notices of assessment to [respondent] precludes this civil action" (App., *infra*, 9a).[2]

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[2] Respondent had also filed a previous motion for summary judgment, arguing inter alia that the undisputed facts showed it to be unaware that Dri-Mix was delinquent in its employment taxes, and contending that the government could not recover for that reason. See R. 345-346. The district court denied that motion. On respondent's cross-appeal, the court of appeals affirmed the district court, noting that respondent's counsel had "all but conceded at oral argument" that the cross-appeal was "without merit." App., *infra*, 2a, 3a. We have no occasion to address that aspect of the decision below.

3. The court of appeals affirmed the dismissal of the government's complaint (App., *infra*, 1a-4a). It rejected the government's argument that Section 6303(a) requires notice only to those persons against whom taxes have actually been assessed, and not to third parties who might under certain circumstances incur a personal liability for part or all of the assessed tax (App., *infra*, 2a-3a). Citing the Seventh Circuit's opinion in *Associates Commercial*, the court of appeals stated that, "[s]ince § 3505 did not exempt from § 6303(a) lenders potentially liable, and since no other exemption could be found, * * * the lender, 'a person liable for the unpaid tax' within the meaning of § 6303(a), was entitled to notice of assessment of the unpaid tax" (App., *infra*, 2a-3a (citing 721 F.2d at 1098)). The court further concluded that the Commissioner's "failure to provide [respondent] with the § 6303(a) notice bars the present suit" (App., *infra*, 3a).

REASONS FOR GRANTING THE PETITION

The court of appeals has decided an important question of federal tax law in a way that squarely conflicts with a recent decision of the Third Circuit. The decision below would produce an irrational result, for it would require the IRS, when making an assessment against a taxpayer, to notify a group of third parties whose identities the IRS typically would not know at the time. The notice required by the court of appeals would take the form of a tax bill that those third parties would not then be expected to pay, and that bill would be in an amount that would rarely if ever correspond to any future liability that the government might seek to establish against them in a civil suit under Section 3505. The question presented has considerable administrative importance, for the practical effect of the decision below would be to nullify what Congress intended to be an important part of the tax-collection scheme. Review by this Court is therefore appropriate.

1. The decision below is in direct conflict with the Third Circuit's decision in *United States* v. *Jersey Shore State Bank*, 781 F.2d 974 (1986) (*reprinted in* App., *infra,* 15a-36a). That case, like this one, involved a suit by the United States to collect a bank's personal liability for an employer's unpaid withholding taxes. The government's complaint there, as here, alleged that the bank had incurred personal liability both under Section 3505(a), by paying wages directly to employees, and under Section 3505(b), by supplying funds to the employer for the specific purpose of paying wages, with knowledge that the employer did not intend, or would not be able, to pay over the required withholding taxes (App., *infra*, 16a). The bank there contended, as respondent contended below, that Section 6303(a) required the IRS to notify it of the assessment against the employer within 60 days of making that assessment (App., *infra*, 16a). And the bank there moved for summary judgment, as respondent did below, on the theory that the Commissioner's failure to give it the notice specified in Section 6303(a) barred the United States from bringing suit to collect the bank's liability under Section 3505 (App., *infra*, 16a-17a).

The Third Circuit squarely rejected the bank's argument, explicitly declining to follow the decisions of the Eleventh Circuit below and of the Seventh Circuit in *Associates Commercial.* See App., *infra*, 20a & n.2, 21a-27a, 30a-31a, 32a. The Third Circuit pointed out that the "plain language" of Section 6303(a), contrary to the view of those courts, does not unambiguously require notice to lenders at the time the employer's taxes are assessed (App., *infra,* 21a-22a). The statute speaks of "notice to each person liable for the unpaid tax"; at the time of the assessment against the employer, the Third Circuit observed, the employer's lenders (as contrasted with the employer himself) have not a present but only a "potential liability" to pay the unpaid tax (*id.* at 23a). The

statute, moreover, as the Third Circuit observed, "requires notice of a particular kind: i.e., one '*stating the amount [of the tax] and demanding payment thereof*' " (*id.* at 22a (emphasis in original), quoting I.R.C. § 6303(a)). Upon making an assessment against the employer, the Third Circuit pointed out, the IRS has no authority to "demand payment" from lenders, for their liability can be collected only by the Department of Justice in a civil suit instituted for that purpose. App., *infra,* 22a, 25a & n.5. See I.R.C. §§ 7401, 7402. And the tax bill that Section 6303(a) requires the IRS to send the employer, the Third Circuit observed, would rarely if ever "state[] the amount" (I.R.C. § 6303(a)) of a lender's potential liability, since that bill would include the employer's own share of the payroll taxes, for which lenders are not liable, and since the amount of a lender's liability could be affected both by the timing of its loans and by a statutorily-specified "cap" under Section 3505(b) (See App., *infra,* 22a-23a). For all these reasons, the Third Circuit concluded, "the more natural and logical reading" of the statutory language was that urged by the government and rejected by the court of appeals below—that "section 6303(a) requires notice only to those individuals against whom the taxes have been assessed" (App., *infra,* 23a).

Even if Section 6303(a) were construed to require notice to lenders, the Third Circuit continued (App., *infra,* 24a-29a), it would by no means follow that the Commissioner's failure to provide such notice would foreclose the United States from bringing a civil suit to collect the lender's liability under Section 3505. It has been "long settled that the government's failure to assess its taxes [does] not preclude it from exercising its common-law right to sue for the taxes" (App., *infra,* 24a (citing authority)). Indeed, the Code explicitly recognizes that the United States may timely bring a "proceeding in court *without assessment* for the collection of [a] tax" (I.R.C. § 6501(a) (em-

phasis added); see I.R.C. §§ 7401, 7402). And it is "equally well settled that where the government ha[s] assessed the taxes but failed to provide the taxpayer with notice of that assessment, it c[an] still proceed by suit to collect the taxes owed" (App., *infra,* 24a (citing cases)).

The rationale for this well-settled rule, the Third Circuit observed (App., *infra,* 24a-25a), is that notice and demand under Section 6303(a) are chiefly designed to protect the taxpayer from surprise collection activity, something that cannot happen in the case of a civil suit. Once a tax has been assessed, the IRS is empowered to collect the tax from any person against whom it has been assessed by a variety of summary devices, such as levy, seizure, and sale of property (App., *infra,* 25a). Notice under Section 6303(a) enables a taxpayer to avoid such enforced collection by promptly paying the tax bill tendered to him. In order to protect the taxpayer, therefore, the Code explicitly requires the Commissioner to provide notice and demand under Section 6303(a) before seeking to collect a tax administratively. *E.g.,* I.R.C. §§ 6321, 6322 (tax liens), 6331 (levy and seizure).

Where the government seeks to collect a liability by civil suit, on the other hand, not only does the Code not require notice and demand under Section 6303(a), but, as the Third Circuit observed, "the need for [such] notice * * * is not nearly so self-evident" (App., *infra,* 25a). The government in such a case cannot "employ its summary collection methods" against the defendant, who is thus "in no danger of having his property immediately seized or attached to satisfy the obligation" (*id.* at 26a). "In a civil action," therefore, "service of the government's complaint provides the [defendant] with all the notice and protection required" (*ibid.*).

Relying on these considerations, the Third Circuit concluded that the Commissioner's failure to notify a bank under Section 6303(a) "does not bar [the government's]

suit to collect the [b]ank's liability under section 3505" (App., *infra,* 29a). Since the IRS cannot summarily collect a Section 3505 liability, the notice and demand specified in Section 6303(a), if directed to a lender, would be deprived of its usual function. And since a lender cannot be held liable in a civil suit unless the government proves either that the lender itself paid wages without paying the required withholding taxes (I.R.C. § 3505(a)) or that the lender supplied funds to the employer with "actual * * * knowledge" that the employer would not pay over those taxes (I.R.C. § 3505(b)), formal notification from the IRS of the assessment against the employer would rarely tell a potentially-liable lender anything that it did not already know. The Third Circuit thus concluded (App., *infra,* 30a-31a) that the notice mandated by the Seventh Circuit and by the court of appeals below "serves no useful purpose," but "simply adds an additional formalistic requirement for the imposition of section 3505 liability."

2. In declining to follow the decision below, the Third Circuit reached a result that accords with the statutory language, with the overall statutory scheme, and with Congress's purpose in enacting Section 3505. Congress enacted that provision in 1966 (Federal Tax Lien Act of 1966, Pub. L. No. 89-719, § 105(a), 80 Stat. 1138) in response to a practice generally known as "net payroll financing," which was especially common in the case of employers experiencing financial difficulties. See H.R. Rep. 1884, 89th Cong., 2d Sess. 20 (1966). Under that practice, a third party—typically a surety, bank, or general contractor—would supply funds for the payment of wages, thus keeping the employer afloat. However, in order to limit its own exposure, the lender would supply an amount equal only to the "net," or after-tax, wages due the employees, without paying, "either to the employees or to the Government, the withholding taxes due the Govern-

ment" (*ibid.*). Although employers in such circumstances remained liable for the unpaid withholding taxes, Congress found that they "were likely to be without financial resources and, as a result, [that] recourse against them [might] well be fruitless." S. Rep. 1708, 89th Cong., 2d Sess. 21 (1966). Under pre-1966 law, moreover, recourse could not be had against the lender either, since the lender was not an "employer," as defined by statute, with respect to the withholding taxes (*ibid.*). To stem this loss of revenue, Congress in Section 3505 imposed liability on third parties who engaged in net payroll financing, concluding that such lenders "sit in essentially the same position vis-a-vis control over payroll funds and access to information as the employer itself." *Jersey Shore State Bank* (App., *infra,* 19a). See H.R. Rep. 1884, *supra,* at 20; S. Rep. 1708, *supra,* at 22.

Nothing in the language or legislative history of Section 3505 suggests that Congress intended a lender's liability thereunder to hinge on whether it had received notice and demand of the sort described in Section 6303(a). Indeed, the mechanism that Congress prescribed for collecting the lender's liability, which differs significantly from the mechanism prescribed for collecting certain other third-party liabilities under the Code, clearly suggests the reverse. Congress has provided, for example, that the liability of certain transferees (I.R.C. § 6901(a)) and of responsible officers (I.R.C. § 6672(a)) "shall be assessed and collected in the same manner as [the] taxes" of the taxpayer itself. I.R.C. § 6671(a); see I.R.C. § 6901(a). The Commissioner is thus empowered to collect such third-party liabilities by levy and other summary devices, and, before such administrative collection steps can be taken, "notice and demand" (I.R.C. § 6671(a)) to the third party are necessarily required under Section 6303(a). In the case of a lender's liability under Section 3505, by contrast,

Congress stated that collection could be effectuated only by "the United States [in an] appropriate civil proceeding." H.R. Rep. 1884, *supra,* at 65-66. Since it was well established in 1966 that the United States could bring a civil proceeding to collect taxes from the taxpayer himself without prior Section 6303(a) notification (see, *e.g.*, *Jenkins* v. *Smith,* 99 F.2d 827 (2d Cir. 1938)), Congress in enacting Section 3505 is unlikely to have contemplated any requirement of prior Section 6303(a) notice to third parties.

In requiring such notice, the court of appeals has opted for an unworkable enforcement scheme that, in practical effect, would largely nullify what Congress intended to be an important part of the tax-collection scheme. When the Commissioner makes an assessment of unpaid payroll taxes, he ordinarily will have no way of knowing whether the delinquent employer has borrowed money from a third party under circumstances that might render the latter liable under Section 3505. There is no indication on the face of a payroll tax return who the employer's creditors might be, much less any indication whether such creditors might themselves have paid net wages (I.R.C. § 3505(a)) or have "actual * * * knowledge" (I.R.C. § 3505(b)) of the employer's withholding tax delinquency. Nor could the Commissioner reasonably be expected, at the time he makes the assessment against the employer, to undertake to identify such lenders. The IRS during 1984 received about 19 million quarterly withholding tax returns, almost six million of which were accompanied by only partial payment or by no payment at all.[3] In order to protect the revenue, the Commissioner typically assesses such delinquent taxes against the employer within a month or two of receiving the return. As the Third Circuit observed in *Jersey Shore State Bank* (App., *infra,* 32a), it would obviously "impose a prohibitory investigative burden on the

[3] These statistics are based on information in IRS files and have been provided to us by the Service.

government" to require the IRS, within 60 days of making those six million assessments, to identify and notify all lenders who might have potential personal liability for the taxes thus assessed.

Even if such investigations were realistically possible, moreover, they would entail a tremendous waste of resources. Like any creditor, the Commissioner naturally tries to collect delinquent payroll taxes first from the employer itself by sending the employer a series of tax bills. If collection efforts against the employer fail, it is the Commissioner's usual practice to try to collect from the employer's responsible persons under Section 6672. Only after those avenues have been investigated does the Commissioner normally explore the possibility of collection from lenders. Indeed, the IRS estimates that Section 3505 comes into play in only about one case for every 5,000 withholding tax delinquencies. Since lenders in the vast majority of cases will never be called upon to pay the delinquent taxes, it would be pointless for the IRS to go to the expense of identifying and notifying them at the very outset of the collection process—a step that would needlessly embarrass employers and convey no useful information to lenders in any event.

For these reasons, the Third Circuit in *Jersey Shore State Bank* concluded without exaggeration that "liability under section 3505 would be rendered a substantial nullity if, as an absolute prerequisite for collection, the government [were] forced to give third parties such as [respondent] notice of its assessment against the taxpayer within sixty days" (App., *infra,* 33a). Properly construed, the court reasoned, the phrase "each person liable for the unpaid tax" in Section 6303(a) refers, not to lenders who might face potential liability in a future civil suit, but "only to those parties against whom the taxes have been assessed, and against whom the government can proceed administratively" (App., *infra,* 26a). "[C]onstruing section 6303(a) as the Seventh Circuit did," the Third Circuit held, interposes a meaningless formal requirement "upon which

parties liable under section 3505 can rely, thereby thwarting Congress' intent to recover the unpaid withholding taxes from such persons" (App., *infra,* 30a-31a).

3. The question presented has considerable importance to the administration of the tax laws. Following the Seventh Circuit's decision in *Associates Commercial,* lenders rapidly realized that they had been afforded a near-absolute defense to liability, since the Commissioner has never provided, and would find it virtually impossible to provide, notice of the sort that the court there ordered. In the two years since *Associates Commercial* was decided, litigation concerning the question presented has accordingly multiplied. Besides the three cases that have already reached decision in the courts of appeals, appeals are now pending in the Third,[4] Eighth,[5] and Ninth Circuits,[6] and the Tax Division informs us that at least a dozen cases are now pending in the district courts. Litigation concerning this question will necessarily continue until the existing conflict in the circuits is resolved by this Court.

Perhaps the most troubling aspect of the rule adopted by the Seventh Circuit and by the court of appeals below is the effect it would have on Section 3505's central deterrent purpose. A principal reason for the comparative paucity of litigation concerning Section 3505 prior to the Seventh Circuit's decision in *Associates Commercial* was that lenders refrained from engaging in net payroll financing

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[4] *United States* v. *American Bank & Trust Co.*, No. 85-1615.

[5] *United States* v. *Messina Builders & Contractors Co.*, No. 85-2505.

[6] *United States* v. *Haryis Construction Co.*, No. 86-1540; *United States* v. *United California Bank*, No. 85-1873; *United States* v. *Hunter Engineers & Constructors, Inc.*, No. 84-2652, (argued Nov. 20, 1985).

for fear of incurring personal liability. By converting Section 3505 virtually into a dead letter, the rule adopted by the Seventh Circuit and by the court below will encourage lenders to return to the very practice that Congress in 1966 determined to stop.

CONCLUSION

The petition for a writ of certiorari should be granted. Respectfully submitted.

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MARCH 1986

APPENDIX A

UNITED STATES COURT OF APPEALS FOR THE ELEVENTH CIRCUIT

Nos. 84-7513, 84-7522

UNITED STATES OF AMERICA,
PLAINTIFF-APPELLANT,
CROSS-APPELLEE,

v.

MERCHANTS NATIONAL BANK OF MOBILE,
DEFENDANT-APPELLEE,
CROSS-APPELLANT.

Decided: Oct. 7, 1985

Before RONEY and FAY, Circuit Judges, and DUMBAULD*, District Judge.

PER CURIAM:

The United States appeals the district court's order granting summary judgment in favor of the defendant, Merchants National Bank of Mobile (MNB). MNB cross-appeals the district court's order denying its first motion for summary judgment. For the reasons which follow, we affirm the district court in all respects.

I. BACKGROUND

On March 18, 1983, the United States brought this action alleging that under 26 U.S.C. § 3505(a) & (b), MNB was liable to it for unpaid federal income and social

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* Honorable Edward Dumbauld, U.S. District Judge for the Western District of Pennsylvania, sitting by designation.

security taxes owed by Dri-Mix Products, Inc. (Dri-Mix). The complaint alleged that beginning in January, 1977, MNB paid wages directly to employees of Dri-Mix and supplied funds to Dri-Mix for the specific purpose of paying net wages to employees with notice or knowledge that Dri-Mix did not intend to, or would not be able to, make timely payment or deposit of the amounts of taxes required by law to be deducted and withheld. *See id.*

MNB answered, and both parties subsequently filed motions for summary judgment. These motions were denied by the district court on May 16, 1984. MNB thereafter sought and was granted leave to amend its answer to assert the affirmative defense that the United States failed to give MNB notice of the assessments against Dri-Mix within the 60-day period required by 26 U.S.C. § 6303(a). Defendant filed its second motion for summary judgment, contending that the United States' failure to give MNB the § 6303(a) notice precluded the United States from bringing suit. The district court, relying on *United States v. Associates Commercial Corp.*, 721 F.2d 1094 (7th Cir. 1983), agreed with MNB and dismissed the complaint with prejudice. The United States filed a timely notice of appeal, and MNB cross-appealed the district court's order denying its first motion for summary judgment.

II. The Notice Requirement

The United States argues on appeal that it was not required to give MNB the § 6303(a) notice of assessment as a prerequisite to suit against MNB for Dri-Mix's unpaid employment taxes. The Seventh Circuit, in *Associates Commercial Corp.*, rejected an identical argument. In that case, the court noted that § 6303(a) "requires that notice of an assessment of unpaid taxes must be provided to 'each person liable for the unpaid tax' within sixty days after the assessment was made, unless otherwise provided by the Internal Revenue Code." 721 F.2d at 1098. Since § 3505 did

not exempt from § 6303(a) lenders potentially liable, and since no other exemption could be found, the court concluded that the lender, a "person liable for the unpaid tax" within the meaning of § 6303(a), was entitled to notice of assessment of the unpaid tax. 721 F.2d at 1098. The court held that the government's failure to provide the statutorily required notice barred its suit. *Id.* We agree with the Seventh Circuit's reading of the applicable statutory provisions and hold that the United States' failure to provide MNB with the § 6303(a) notice bars the present suit against MNB.[1]

III. MNB'S CROSS-APPEAL

MNB appeals the district court's denial of its first motion for summary judgment. Counsel for MNB all but conceded at oral argument, however, that this appeal is without merit. We agree and affirm the district court.

> Summary judgment is appropriate only when the moving party has sustained its burden of proving that there exists no genuine issue of material fact after reviewing all the evidence in the light most favorable to the party opposing the motion. [citations omitted]. The district court's order granting a summary judgment motion is not a discretionary decision and thus will be independently reviewed by the appellate court.

Wong v. Bailey, 752 F.2d 619, 620-21 (11th Cir. 1985). The decision to *deny* a summary judgment, however, is discretionary with a trial court, and we will reverse only for an abuse of discretion. *See Johnson v. Bryant,* 671

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[1] The United States also argues that even if § 6303(a) requires notice to third-parties such as MNB, the failure to give notice does not preclude suit to collect on MNB's alleged § 3505 liability. The United States contends that it has an inherent common law right to sue to collect debts which is entirely independent of the assessment process. Appellant, however, ignores the fact that third-party derivative liability of the sort set forth in § 3505 is a creature of statutory, not common, law. This argument is therefore untenable.

F.2d 1276, 1279 (11th Cir. 1982); *see also Marcus v. St. Paul Fire & Marine Ins. Co.*, 651 F.2d 379, 382 (5th Cir. Unit B 1981) (a district court may, in a proper case, deny "harsh remedy" of summary judgment even if the motion is justifiable under Fed.R.Civ.P. 56, if the court, in "the sound exercise of judicial discretion," decides "to give the parties an opportunity to fully develop the case."). After carefully reviewing the record with these principles in mind, we conclude that the district court did not err in denying MNB's first motion for summary judgment.

AFFIRMED.

APPENDIX B

IN THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF ALABAMA, SOUTHERN DIVISION

Civil Action No. 83-0266-T

UNITED STATES OF AMERICA,
PLAINTIFF,

v.

MERCHANTS NATIONAL BANK OF MOBILE,
DEFENDANT.

Filed: May 31, 1984

FINDINGS OF FACT AND CONCLUSIONS OF LAW

On May 30, 1984, the defendant, Merchants National Bank of Mobile, filed with the court, Second Motion for Summary Judgment for Defendant. The Court, having considered said motion and having carefully examined the record before the Court, is of the opinion that defendant's second motion for summary judgment is due to be granted and, therefore, enters the following findings of fact and conclusions of law.

FINDINGS OF FACT

1. Plaintiff is the United States of America acting by and through its attorney, J. B. Sessions, III, United States Attorney for the Southern District of Alabama.

2. Defendant is the Merchants National Bank of Mobile (hereafter MNB), a national banking association with its principal offices in the County of Mobile, State of Alabama, located at 106 St. Francis Street.

3. The Court has jurisdiction over the action pursuant to § § 1340, 1345 and 1346 of Title 28, United States Code, and § 7402 of the Internal Revenue Code of 1954, Title 26, United States Code.

4. A delegate of the Secretary of the Treasury made assessments for unpaid taxes against Dri-Mix Products, Inc. (hereafter Dri-Mix). The dates of the assessments made against Dri-Mix were November 9, 1977, for the Form 941 unpaid federal employment tax liabilities for the third quarter of 1977, and May 15, 1978, for the Form 941 unpaid federal employment tax liabilities for the fourth quarter of 1977. Notices of the assessments were given to and demands for payment were made on Dri-Mix on those same dates.

5. Plaintiff has alleged that MNB directly paid wages for the year 1977 and during the first quarter of 1978 to employees of Dri-Mix or to an agent on behalf of said employees, and failed to withhold the applicable taxes, thus giving rise to liability under the Internal Revenue Code of 1954, Title 26, § 3505(a).

6. Plaintiff has also alleged that MNB supplied funds to or for the account of Dri-Mix for the specific purpose of paying net wages of employees for the year 1977 and during the first quarter of 1978 with notice or knowledge within the meaning of § 6323(i)(1) of the Internal Revenue Code that Dri-Mix did not intend to, or would not be able to, make timely payment or deposit of the amounts of tax required by federal law to be deducted and withheld from the wages of the employees, thus giving rise to liability under § 3505(b) of the Internal Revenue Code.

7. The Court finds that at no time did plaintiff give, nor [did] MNB receive, any written notice of the assessments against Dri-Mix and MNB specifically did not receive any such notice within sixty (60) days of the assessments made on November 9, 1977, and May 15, 1978. (Affidavit of Clarence C. Keller attached hereto)

CONCLUSIONS OF LAW

1. Summary judgment is due to be granted to MNB with respect to any alleged liability under § 3505(a) for direct payment of wages, or under § 3505(b) for supplying funds to be used for the specific purpose of paying wages with knowledge that the employer did not intend to, or was unable to, make timely deposit of withholding taxes because of plaintiff's failure to give notice of the assessments against Dri-Mix to MNB as required by § 6303(a) of the Internal Revenue Code, 26 U.S.C.A. § 6303(a).

2. Section 6303(a) provides as follows:

> *General Rule*—Where it is not otherwise provided by this title, the Secretary or his delegate shall, as soon as practicable, and within sixty (60) days, after the making of an assessment of a tax pursuant to section 6203, give notice to each person liable for the unpaid tax, stating the amount and demanding payment thereof. Such notice shall be left at the dwelling or usual place of business of such person, or shall be sent by mail to such person's last known address.

3. Until quite recently, there seemed to be no clear rule as to the applicability of § 6303(a) to any alleged liability under § 3505. However, the Seventh Circuit has recently decided this issue in the case of *United States v. Associates Commercial Corporation*, 721 F.2d 1094 (7th Cir. 1983). Therein, the Court found that application of § 6303(a)'s notice provisions gave effect to the intent of Congress to narrow the scope of § 3505 liability. Therein, the Court stated:

> [F]ailure to apply Section 6303(a)'s notice provisions would increase the likelihood of imposing derivative tax liability on lenders that Section 3505(b) was designed to protect and whose ability to defend against liability would of course be diminished absent

> prompt notice of the government's potential claim. [Citation omitted]. Thus instead of defeating Congress' intent, as the government argues, applying Section 6303(a)'s notice provisions to lenders allegedly subject to Section 3505(b) liability gives effect to that intent.[1]
>
> 721 F.2d at 1099.

4. The Seventh Circuit relied on the rationale of the Ninth Circuit in *United States v. Dixie Line Financial, Inc.*, 594 F.2d 1311 (9th Cir. 1979), which recognized that § 6303(a) applied to § 3505 cases, but did not reach a conclusion as to "the consequences that flow from that fact." 594 F.2d at 1313.

5. The Seventh Circuit answered that question in rejecting the Government's contentions that failure to give notice would not preclude a civil action alleging § 3505 liability, stating:

> Section 6303(a) itself does not indicate that the right to notice is dependent on which tax collection option the government uses. [Citation omitted]. Section 6303(a) requires notice of the assessment of unpaid taxes in order to protect the person liable for paying the taxes, *see MacAtee, Inc. v. United States,* 214 F.2d 717, 719 (5th Cir. 1954), and this rationale applies regardless of which collection mechanism is used.
>
> 721 F.2d at 1100.

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[1] The Government correctly argues that there is no general requirement that a potential defendant receive notice that a suit may be instituted against it. However, the care with which Congress developed the very narrow remedy provided in Section 3505(b) and the absence of any language in that statute to override Section 6303(a)'s notice requirement convinced us that there is a particular requirement of notice of assessment here, thus alerting a lender to a possible civil action.

Thus, § 6303(a) applies to cases alleging § 3505 liability, whether for direct payment under § 3505(a) or indirect payment under § 3505(b), and the failure of plaintiff to give the required notices of assessment to MNB precludes this civil action.

6. Based on the foregoing findings of fact and conclusions of law, the Court is of the opinion that there exists no genuine issue of material fact.

7. A Judgment will be entered for the defendant in accordance herewith.

DONE this the 31st day of May 1984.

/s/ Daniel H. Thomas
UNITED STATES DISTRICT JUDGE

APPENDIX C

UNITED STATES COURT OF APPEALS FOR THE ELEVENTH CIRCUIT

Nos. 84-7513, 84-7522

D.C. Docket No. 83-0266

UNITED STATES OF AMERICA,
PLAINTIFF-APPELLANT,
CROSS-APPELLEE,

v.

MERCHANTS NATIONAL BANK OF MOBILE,
DEFENDANT-APPELLEE,
CROSS-APPELLANT.

Appeals from the United States District Court for the Southern District of Alabama

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Before RONEY and FAY, Circuit Judges, and DUMBAULD*, District Judge.

JUDGMENT

These causes came on to be heard on the transcript of the record from the United States District Court for the Southern District of Alabama, and were argued by counsel;

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* Honorable Edward Dumbauld, U.S. District Judge for the Western District of Pennsylvania, sitting by designation.

ON CONSIDERATION WHEREOF, it is now here ordered and adjudged by this Court that the judgments of the said District Court in these causes be and the same are hereby, AFFIRMED;

It is further ordered that plaintiff-appellant/cross-appellee pay to defendant-appellee/cross-appellant, the costs on appeal to by taxed by the Clerk of this Court.

Entered: October 7, 1985

For the Court: Spencer D. Mercer, Clerk

ISSUED AS MANDATE: NOV 25 1985

APPENDIX D

IN THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF ALABAMA, SOUTHERN DIVISION

Civil Action No. 83-0266-T

UNITED STATES OF AMERICA,
PLAINTIFF,

v.

MERCHANTS NATIONAL BANK OF MOBILE,
DEFENDANT.

JUDGMENT

Pursuant to the Findings of Fact and Conclusions of Law this day entered, it is hereby ORDERED, ADJUDGED and DECREED that the Second Motion for Summary Judgment filed by the defendant, The Merchants National Bank of Mobile, is GRANTED.

It is FURTHER ORDERED, ADJUDGED and DECREED that this action is hereby DISMISSED WITH PREJUDICE.

Costs taxed against the plaintiff.

DONE this the 31st day of May 1984.

Daniel H. Thomas

UNITED STATES DISTRICT JUDGE

APPENDIX E

Internal Revenue Code of 1954 (26 U.S.C.), as amended and as in effect for the years at issue:

SEC. 3505. LIABILITY OF THIRD PARTIES PAYING OR PROVIDING FOR WAGES.

(a) *Direct Payment By Third Parties.* – For purposes of sections 3102, 3202, 3402, and 3403, if a lender, surety, or other person, who is not an employer under such sections with respect to an employee or group of employees, pays wages directly to such an employee or group of employees, employed by one or more employers, or to an agent on behalf of such employee or employees, such lender, surety, or other person shall be liable in his own person and estate to the United States in a sum equal to the taxes (together with interest) required to be deducted and withheld from such wages by such employer.

(b) *Personal Liability Where Funds Are Supplied.* – If a lender, surety, or other person supplies funds to or for the account of an employer for the specific purpose of paying wages of the employees of such employer, with actual notice or knowledge (within the meaning of section 6323(i)(1)) that such employer does not intend to or will not be able to make timely payment or deposit of the amounts of tax required by this subtitle to be deducted and withheld by such employer from such wages, such lender, surety, or other person shall be liable in his own person and estate to the United States in a sum equal to the taxes (together with interest) which are not paid over to the United States by such employer with respect to such wages. However, the liability of such lender, surety, or other person shall be limited to an amount equal to 25 percent of the amount so supplied to or for the account of such employer for such purpose.

(c) *Effect of Payment* – Any amounts paid to the United States pursuant to this section shall be credited against the liability of the employer.

* * * * *

SEC. 6303. NOTICE AND DEMAND FOR TAX.

(a) *General Rule.* – Where it is not otherwise provided by this title, the Secretary shall, as soon as practicable, and within 60 days, after the making of an assessment of a tax pursuant to section 6203, give notice to each person liable for the unpaid tax, stating the amount and demanding payment thereof. Such notice shall be left at the dwelling or usual place of business of such person or shall be sent by mail to such person's last known address.

(b) *Assessment Prior To Last Date For Payment.* – Except where the Secretary believes collection would be jeopardized by delay, if any tax is assessed prior to the last date prescribed for payment of such tax, payment of such tax shall not be demanded under subsection (a) until after such date.

APPENDIX F

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 85-5263

UNITED STATES OF AMERICA,
Appellant

v.

JERSEY SHORE STATE BANK,
Appellee

Appeal from the United States District Court
for the Middle District of Pennsylvania

Argued: November 5, 1985

Present: SEITZ, WEIS, and ROSENN,
Circuit Judges

(Opinion Filed: January 10, 1986)

OPINION OF THE COURT

SEITZ, *Circuit Judge.*

The United States appeals from an order of the district court granting summary judgment in favor of the defendant, Jersey Shore State Bank ("Jersey Shore" or "the Bank"). This court has jurisdiction over the appeal by virtue of 28 U.S.C. § 1291 (1982).

I.

The United States brought this action alleging that Jersey Shore was personally liable under I.R.C. § 3505(a) and (b) (1982) for the unpaid federal withholding tax liabilities of Pennmount Industries, Inc. ("Pennmount"). The complaint alleged that from the fourth quarter of 1977 through the first quarter of 1980, Jersey Shore (i) paid wages directly to Pennmount employees and (ii) supplied funds to Pennmount for the specific purpose of paying wages with actual notice and knowledge that Pennmount did not intend to, or would not be able to, make timely payments or deposits of the federal taxes required to be deducted and withheld. The complaint also alleged that the Bank's liability under section 3505(a) totals $76,547.57 plus interest, and that its liability under section 3505(b) totals $72,069.00 plus interest.

In its answer, Jersey Shore admitted making commercial loans to Pennmount, but denied any liability under section 3505. The Bank also alleged that the complaint failed to state a claim upon which relief could be granted, because the United States did not provide it with timely notice of the assessments against Pennmount, which it asserted were required by I.R.C. § 6303(a) (1982).

The United States moved for partial summary judgment with respect to the first count of its complaint, which involved Jersey Shore's liability under section 3505(a). At the same time, the Bank moved for summary judgment on both counts of the government's complaint, arguing that the government's failure to give it notice of the assessments against Pennmount pursuant to section 6303(a) precluded the United States from bringing suit. In its reply, the United States admitted that Jersey Shore had not been given notice pursuant to section 6303(a), but argued that it was not required to give the Bank such notice and, alternatively, that even assuming that such

notice was required, the failure to give it did not bar the United States from bringing suit to collect the Bank's liability under section 3505.[1]

Relying upon the Seventh Circuit's opinion in *United States v. Associates Commercial Corp.*, 721 F.2d 1094 (7th Cir. 1983), the district court held that where a lender is liable under section 3505 for another's withholding taxes, the government is required by section 6303(a) to give notice of the assessment against the employer to the lender within sixty days of the assessment. It concluded that the government's failure to give timely notice to Jersey Shore of the assessments against Pennmount barred the United States from bringing suit. This appeal followed.

II.

Prior to 1966, only "employers" were liable for income, social security, and railroad retirement taxes required to be withheld and deducted from employee wages—despite the many situations in which persons other than employers directly or indirectly paid the wages. Problems arose when these third parties paid the employees only "net" wages, neglecting to pay to the government the withholding taxes due. When this occurred, the government was often unable to collect the taxes required to be deducted and withheld, despite the fact that it was required to credit the employees' accounts for them. Recourse against the employer was often fruitless, because it was frequently without any financial resources. And the government could not proceed against the third parties who paid the net wages, because they were not "employers" under the Code and, therefore, were not liable for the taxes. S. Rep. No. 1708, 89th Cong., 2d Sess. 21-22, *reprinted in* 1966

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[1] The United States also argued that Jersey Shore received actual notice of its potential liability for Pennmount's withholding taxes as early as January of 1979.

U.S. Code Cong. & Ad. News 3722, 3742-43 [hereinafter cited as S. Rep. No. 1708]; H.R. Rep. No. 1884, 89th Cong., 2d Sess. 20 (1966) [hereinafter cited as H.R. Rep. No. 1884].

This practice, commonly known as "net payroll financing," was apparently quite prevalent in the construction industry. *See generally United States v. Algernon Blair, Inc.*, 441 F.2d 1379 (5th Cir. 1971). In an attempt to keep work moving along smoothly, prime contractors would provide their financially troubled subcontractors with the funds necessary to meet their payrolls, *see id.* at 1381, or would help them arrange the necessary credit through a third-party lender, *see United States v. Coconut Grove Bank*, 545 F.2d 502, 505 (5th Cir. 1977). However, anxious to limit their exposure on such transactions, the prime contractor or third-party lender typically provided the subcontractor funds only to the extent of its *net* payroll, thus making the government an unwilling "co-lender" of such loans to the extent of the withholding taxes due.

To stem this loss of revenue, Congress enacted section 3505. *See Coconut Grove Bank*, 545 F.2d at 505; *Algernon Blair, Inc.*, 441 F.2d at 1381. It imposes liability on lenders, sureties, and other third parties in two specific situations. First, section 3505(a) provides, in pertinent part, that:

> if a lender, surety, or other person, who is not an employer with respect to an employee . . . pays wages *directly* to such an employee . . . such lender, surety, or other person shall be liable in his own person and estate to the United States in a sum equal to the taxes (together with interest) required to be deducted and withheld [emphasis added].

Similarly, section 3505(b) provides, in pertinent part, that:

> [i]f a lender, surety, or other person supplies funds to . . . an employer for the *specific purpose of paying*

> *wages* of the employees of such employer, with *actual notice or knowledge* . . . that such employer does not intend to or will not be able to make timely payment or deposit of the amounts of tax required . . . to be deducted and withheld by such employer . . . such lender, surety, or other person shall be liable in his own person and estate to the United States in a sum equal to the taxes (together with interest) which are not paid over to the United States by such employer [emphasis added].

In short, Congress thought it fair to impose liability on third parties like Jersey Shore in these two situations, because they sit in essentially the same position vis-a-vis control over payroll funds and access to information as the employer itself. *See* S. Rep. No. 1708, at 22 (observing that given the amount of information available to such third parties and the burden of proof upon the government, there is "no reason for distinguishing between the portion of the total wages which is owed and should be paid to employees . . . and the portion of the wages which is owed and should be paid to the Government"); H.R. Rep. No. 1884, at 20 (*id.*).

With this background, we turn to the issue posed by the present appeal: Whether the government's failure to provide Jersey Shore with notice of the assessments against Pennmount pursuant to I.R.C. § 6303(a) (1982) bars its suit to collect the Bank's liability under I.R.C. § 3505 (1982).

III.

"When interpreting a statute, the starting point is of course the language of the statute itself. If the language is clear and unambiguous, and there is no 'clearly expressed legislative intention to the contrary, that language must ordinarily be regarded as conclusive.' " *National Freight v.*

Larson, 760 F.2d 499, 503 (3d Cir.) (citation omitted), *cert. denied*, 106 S. Ct. 228 (1985), *quoting Consumer Prod. Safety Comm'n v. GTE Sylvania*, 447 U.S. 102, 108 (1980).

Section 6303(a), the notice provision presently at issue, is found in Subtitle F of the Internal [Revenue] Code, which governs procedure under and administration of the internal revenue laws. It provides, in pertinent part, as follows:

> § 6303. Notice and demand for tax
> (a) General rule
> Where it is not otherwise provided by this title, the Secretary shall, as soon as practicable, and within 60 days, after the making of an assessment of a tax pursuant to section 6203, give notice to each person liable for the unpaid tax, stating the amount and demanding payment thereof.

Jersey Shore argues that the phrase "each person liable for the unpaid tax" requires that notice of the assessment be sent not only to the persons against whom the assessment has been made, but to every third party who might be liable for the tax, including those liable under section 3505.

This interpretation of section 6303(a) concededly derives some support from a literal reading of the language of the statute. *See Associates Commercial Corp.*, 721 F.2d at 1098 (holding that "since Associates is a 'person liable for the unpaid tax' for the purposes of Section 6303(a), it is entitled to notice of the assessment of the unpaid tax mandated by that statute") (citation omitted); *accord, United States v. Merchants Nat. Bank*, 772 F.2d 1522, 1524 (11th Cir. 1985) (per curiam).[2] However, even

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[2] In addition to the Seventh and Eleventh Circuits, the district courts that have addressed this question are in substantial agreement that failure to provide a third party with notice pursuant to section 6303(a) bars suit under section 3505(a) and (b). *See United States v.*

"the use of the words of the statute as the primary guide to its interpretation requires an appreciation of the general purpose of the legislation so that literalism does not frustrate that purpose." *Schiaffo v. Helstoki*, 492 F.2d 413, 428 (3d Cir. 1974). A court must, therefore, look beyond the express language of a statute to give force to Congressional intent in two circumstances: "where the statutory language is ambiguous; and where a literal interpretation would thwart the purpose of the overall statutory scheme or lead to an absurd result." *International Tel. & Tel. Corp. v. General Tel. & Elecs. Corp.*, 518 F.2d 913, 917-18 (9th cir. 1975); *see also Government of the Virgin Islands v. Berry*, 604 F.2d 221, 225 (3d Cir. 1979) (" 'All laws should receive a sensible construction. General terms should be so limited in their application as not to lead to . . . an absurd consequence. . . . The reason of the law in such cases should prevail over its letter.' ") (quoting *United States v. Kirby*, 74 U.S. (7 Wall.) 482, 486-87 (1868)). And any construction of a particular statute that would render all or part of the statutory scheme a "dead letter" is disfavored and to be avoided. *See Commissioner v. Bilder*, 289 F.2d 291, 298 (3d Cir. 1961), *rev'd on other grounds,* 369 U.S. 499 (1962).

A.

First, unlike the Seventh Circuit, we find the "plain meaning" of the statute less than wholly unambiguous. Section 6303(a) not only requires the government to "give

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Messina Builders and Contractors Co., No. 84-0668-CV-W-9 (W.D. Mo. Oct. 11, 1985); *United States v. American Bank & Trust*, No. 84-5624 (E.D. Pa. Aug. 9, 1985); *United States v. Hunter Eng'rs & Constructors*, No. 83-1305 (D. Hawaii Sept. 6, 1984); *United States v. United Cal. Bank*, No. C-80-3422-WAI (N.D. Cal. Feb. 14, 1985). *But see United States v. National Acceptance Co. of America*, 603 F. Supp. 1351, 1353 (E.D. Mich. 1985) (rejecting *Associates Commercial Corp.*, and holding that the government may sue to collect a lender's liability under section 3505 without giving section 6303(a) notice).

notice to each person liable for the amount of the tax," it also requires notice of a particular kind: i.e., one "*stating the amount and demanding payment thereof.*" In other words, a section 6303(a) notice consists of two discrete elements: (i) notice of the amount that has been assessed and (ii) a *demand* that the individual receiving the notice *presently* satisfy that assessment. Thus, the plain language of the statute envisions a notice not unlike a typical creditor's dunning letter, providing the individual receiving it with one last opportunity to pay the taxes before the government invokes the full panoply of its administrative collection powers. *See generally* M. Saltzman, *IRS Practice and Procedure* ¶ 14.01 (1981) (comparing tax collection with debt collection under the Uniform Commercial Code); *see also id.* ¶ 14.03 (describing the processing of tax collection cases); McGregor & Davenport, *Collection of Delinquent Federal Taxes*, 28 S. Cal. Tax Inst. 589, 761-82 (1976) (describing the process of collecting delinquent withholding taxes) [hereinafter cited as McGregor & Davenport, *Collection of Delinquent Federal Taxes*].

In sharp contrast to this type of notice is that contemplated by Jersey Shore and required by the Seventh Circuit. After *Associates Commercial Corp.*, the government must provide third parties like Jersey Shore with a copy of the notice of assessment and demand for payment sent to employers like Pennmount within sixty days of the assessment of such taxes. But such a notice serves quite a different purpose than that described above. First, it does not *demand* payment from the third party receiving the notice; nor does it even indicate the likelihood that the government will, at some time prior to the expiration of the applicable statute of limitations, look to that third party for payment. Similarly, such a "notice" will only fortuitously reflect the third party's potential liability, given both the differences between the taxes for which the employer and third party are liable and the limitations on

liability contained within section 3505 itself. For example, the third party's liability is limited to those taxes required to be deducted and withheld from the employees' wages; it "is not liable for the employer's portion of payroll taxes." S. Rep. No. 1708, at 23; H.R. Rep. No. 1884, at 21. The notice and demand sent to the employer, however, does include these amounts. Thus, it overstates the third party's potential liability. Similarly, under section 3505(b), the third party's liability is limited to twenty-five percent of the money lent, which may or may not equal the amount assessed against the employer. And unless the time period in which the third party paid net wages directly corresponds precisely with that reflected in the assessment, the third party's liability under section 3505(a) will not equal that shown on the notice sent to the employer.

Accordingly, we find that section 6303(a) can plausibly be read to support the position of both the government and Jersey Shore, thus justifying our resort to its legislative history and prior judicial treatment to determine its proper construction. In fact, to the extent we find the "plain meaning" of the statute controlling, we find the government's construction of the statute the more natural and logical reading of the languge: i.e., section 6303(a) requires notice only to those individuals against whom the taxes have been assessed. *See Guide to the Internal Revenue Code of 1954*, 1955 U.S. Code Cong. & Ad. News 1183, 1621 ("Subsequent to a valid assessment of any tax liability, . . . the Secretary . . . must, as soon as practicable, and within 60 days, after the making of the assessment serve a notice on the *delinquent taxpayer* stating the amount due and demanding payment thereof.") (emphasis added; footnote omitted); Andrews, *The Use of the Injunction as a Remedy for an Invalid Federal Tax Assessment*, 40 Tax L. Rev. 653, 658 (1985) ("As soon as practicable, and within 60 days after making the assessment, the Service is required to give *the taxpayer* notice of the unpaid amount and demand for its payment . . . .") (emphasis added).

B.

Under the Internal Revenue Code of 1939, the predecessor statute to section 6303(a) explicitly applied only to the collection efforts of the tax Collector, who by statute was authorized to collect taxes solely by administrative means, such as levying on the taxpayer's property. I.R.C. § 3655 (1952).[3] By contrast, the Commissioner of Internal Revenue was authorized to bring civil suits to collect taxes owed. *Id.* § 3740. And it was long settled that the government's failure to assess its taxes did not preclude it from exercising its common-law right to sue for the taxes. *See, e.g., Macatee, Inc. v. United States*, 214 F.2d 717, 719-20 (5th Cir. 1954).[4] It was equally well settled that where the government had assessed the taxes but failed to provide the taxpayer with notice of that assessment, it could still proceed by suit to collect the taxes owed. *United States v. Erie Forge Co.*, 191 F.2d 627 (3d Cir. 1951), *cert. denied*, 343 U.S. 930 (1952); *Jenkins v. Smith*, 99 F.2d 827 (2d Cir. 1938); *see also Marvel v. United States*, 719 F.2d 1507, 1513-14 (10th Cir. 1983) (alternative holding).

Where the government intends to proceed administratively to collect the taxes due, the need for the notice provided by section 6303(a) and its predecessor statutes is readily apparent. The 1939 and 1954 Codes both provide that upon assessment and demand, all of the taxpayer's

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[3] Section 3655 provided, in pertinent part, that:

> Where it is not otherwise provided, the collector shall . . . within ten days after receiving any list of taxes from the Commissioner, give notice to each person liable to pay any taxes stated therein, . . . stating the amount of such taxes and demanding payment thereof.

[4] The government's right to bring suit in this fashion was based simply on its common-law right to sue on a debt, which exists independently of any statute. *See, e.g., Dollar Savings Bank v. United States*, 86 U.S. (19 Wall.) 227, 239-40 (1874); *Damsky v. Zavatt*, 289 F.2d 46, 51 (2d Cir. 1946) (Friendly, J.).

property, both real and personal, becomes subject to a lien in favor of the United States. I.R.C. §§ 6321, 6322 (1982); I.R.C. §§ 3670, 3671 (1952). If the taxpayer neglects or refuses to pay the taxes within ten days after notice and demand, the government may levy on or distrain any property belonging to the taxpayer on which a tax lien exists. I.R.C. § 6331(a), (b) (1982); I.R.C. §§ 3690, 3692, 3700 (1952). And after levying on or distraining the taxpayer's property, the government may sell it to satisfy the taxes owed. I.R.C. §§ 6331(b), 6335 (1982); I.R.C. §§ 3693, 3695(a)-(b), 3712 (1952). Thus, given the scope of the government's power to collect summarily the taxes owed under this statutory scheme, the notice required by sections 3655 and 6303(a) plays an important role: "[t]he purpose of requiring such a notice and demand is for the protection of the taxpayer." *Macatee, Inc.*, 214 F.2d at 719.

Where, as under section 3505,[5] the goverment cannot proceed administratively, the need for notice under section 6303(a) is not nearly so self-evident. If the government

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[5] Unlike its treatment of various other third-party liabilities, Congress did not authorize the Internal Revenue Service to assess separately third parties liable under section 3505, which would have empowered the government to proceed administratively. *Cf., e.g.*, I.R.C. § 6671(a) (1982) (providing that liability under section 6672 is to be "assessed and collected in the same manner as taxes"). Rather, Congress apparently intended that liabilities under section 3505 be collected in civil proceedings only:

> In the event a payor does not voluntarily satisfy the liability imposed by section 3505(a), the United States may collect such liability by appropriate civil proceeding. . . .
>
> In the event a supplier of funds does not voluntarily satisfy the liability imposed by section 3505(b), the United States may collect such liability by appropriate civil proceeding.

H.R. Rep. No. 1884, at 65-66; *see also United States v. First Nat. Bank*, 652 F.2d 882, 889 (9th Cir. 1981) (holding that liability under section 3505 cannot be separately assessed): *United States v. Dixieline Fin.*, 594 F.2d 1311, 1313 (9th Cir. 1979) (*id.*).

cannot assess the third party's liability, it cannot employ its summary collection methods against that party. Thus, such a third party is in no danger of having his property immediately seized or attached to satisfy the obligation. In a civil action, then, service of the government's complaint provides the party with all the notice and protection required; thus, the language "each person liable for the unpaid tax," then, refers only to those parties against whom the taxes have been assessed, and against whom the government can proceed administratively.

The Seventh Circuit, however, rejected any interpretation of section 6303(a) that differentiated between the manner in which the government attempts to collect the taxes owed:

> Section 6303(a) itself does not indicate that the right to notice is dependent upon which tax collection option the government uses. Section 6303(a) requires notice of the assessment of unpaid taxes in order to protect the person liable for paying the taxes, and this rationale applies regardless of which collection mechanism is used.

721 F.2d at 1100 (citations omitted). In so doing, it distinguished those cases beginning with *Jenkins v. Smith*, 99 F.2d 827 (2d Cir. 1938) (per curiam), that stood for the proposition that the government's failure to give the notice required by section 6303(a) and its predecessor statutes barred only the its right to collect the taxes administratively. It based this conclusion on what it apparently considered to be a critical organizational change in the statutory scheme enacted in 1954:

> *Jenkins* and its progeny do not support the government's position. Section 1545 [a predecessor to sections 3655 and 6303(a)] was part of a statutory scheme quite different from that of which Section 6303(a) is now a part. Under the earlier scheme, the

> tax Collector had no authority to collect taxes by means of a civil proceeding, whereas under the Internal Revenue Code of which Section 6303 is a part, the Secretary of the Treasury . . . may collect the unpaid tax by levy (§ 6331) or by civil proceeding (§ 7401). . . . By necessary implication, then, where, as here, the same official . . . has power both to collect by levy and to authorize civil collection proceedings, . . . the failure to provide [the] statutorily required notice bars both recovery methods.

Id. As we read the court's opinion, then, the court focused primarily upon the official in whom the power to collect the taxes had been lodged, rather than on the means by which that official sought to collect them.

After an examination of the administrative and legislative history leading up to the enactment of the Internal Revenue Code of 1954, we find that the Seventh Circuit misconceived the effect of any organizational changes wrought by its enactment. Consideration of the relationship between section 6303(a) of the 1954 Code and its predecessor statutes, combined with an appreciation of the organizational changes effected by President Truman prior to the enactment of the 1954 Code, leads us to conclude that the critical variable is the manner in which the government seeks to collect the taxes, not the official entrusted with that power. Thus, section 6303(a) requires notice only to those individuals against whom the government can proceed administratively.

First, the Committee Reports accompanying section 6303(a) indicate that Congress intended to make only "two changes from existing law," neither of which affects who is entitled to notice of an assessment. H.R. Rep. No. 1337, 83d Cong., 2d Sess. A405-06, *reprinted in* 1954 U.S. Code Cong. & Ad. News 4017, 4553; S. Rep. No. 1622, 83d

Cong. 2d Sess. 574 *reprinted in* 1954 U.S. Code Cong. & Ad. News 4621, 5222-23.[6]

Second, the organizational changes that the court placed so much weight on in *Associates Commercial Corp.* resulted not from Congressional action with respect to the 1954 Code, but from executive action under the 1939 Code. The current organization of the Internal Revenue Service stems from two reorganization plans promulgated by President Truman in 1950 and 1952, which Congress subsequently incorporated by reference when it enacted the 1954 Code. I.R.C. § 7804 (1982); *see also* 4 B. Bittker, *Federal Taxation of Income, Estates and Gifts* ¶ 110.1, at 110-2 to -3 (1981); 9 J. Mertens, *The Law of Federal Income Taxation* § 49.02 (rev. ed. 1982). For example, the power to collect taxes both administratively and by means of a civil proceeding was first vested in the Secretary of the Treasury *under the Internal Revenue Code of 1939* by Reorg. Plan No. 26 of 1950, 15 Fed. Reg. 4935 (1950), *reprinted in* 5 U.S.C.A. app. at 274-75 (West 1967) [hereinafter cited as Reorg. Plan No. 26]. Similarly, the office of the Collector was abolished not by the enactment of the 1954 Code, but by the Reorg. Plan No. 1 of 1952, 17 Fed. Reg. 2243, *reprinted in* 5 U.S.C.A. app. at 280-81 (West 1967) [hereinafter cited as Reorg. Plan No. 1].

In neither case is there any indication that the President intended any change with respect to who was to receive notice of an assessment under the 1939 Code. Rather, the reorganizations had two primary goals: first, to increase the efficiency of the Department of the Treasury and the Internal Revenue Service; and second, to assure the honest and impartial administration of the internal revenue acts.

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[6] Specifically, Congress intended that notice and demand be given as soon as practical but no later than sixty days, rather than within ten days after receipt by the Collector of the Commissioner's certified list of assessments; and that, except in the case of a jeopardy assessment, payment was not to be demanded prior to the last date prescribed by law for the payment of the tax.

See Message of the President, Reorg. Plan No. 26, 5 U.S.C.A. app. at 275 ("the reorganizations contained [herein are] essential to clarification of the lines of authority and responsibility in the executive branch"); Message of the President, Reorg. Plan No. 1, 5 U.S.C.A. app. at 281 ("A comprehensive reorganization of [the Internal Revenue Service] is necessary both to increase the efficiency of its operations and to provide better machinery for assuring honest and impartial administration of the [tax] laws."). In fact, to the limited extent that the administrative history speaks to this issue, it indicates an intent not to change the law substantively. *See, e.g.*, Bureau of Internal Revenue, Operations Reorganization Order No. 3, 17 Fed. Reg. 8126 (1952) (delegating to each Director of Internal Revenue all functions relating to the assessment and collection of taxes and the accountability therefor of the predecessor office of the office of Collector of Internal Revenue in order to preserve the right to maintain suit for the refund of taxes); *see also* T.D. 5900, 17 Fed. Reg. 4464 (1952).

Under these circumstances, we find that Congress did not intend to change the law with respect to who must receive notice when it enacted section 6303(a). Congress was fully aware of the changes wrought by Reorg. Plan No. 26 and Reorg. Plan No. 1 when it enacted the 1954 Code. It only follows that the Congress would adapt the language of the Code to fit the existing organization of the Department of the Treasury and the Internal Revenue Service. Thus, absent any legislative history to the contrary, we find that section 6303(a), like its predecessor statute under the the 1939 Code, only requires notice to those individuals against whom the government can proceed administratively. As a result, the government's failure to provide Jersey Shore with a copy of the notice of assessment and demand for payment sent to Pennmount does not bar its suit to collect the Bank's liability under section 3505.

C.

Careful consideration of the substantive requirement of section 3505 further buttresses our conclusion that section 6303(a) does not require notice to parties like Jersey Shore. In construing section 6303(a) to require notice to third parties like Jersey Shore, the Seventh Circuit was apparently concerned that unless such notice be given, third parties like Jersey Shore would have no reason to suspect that they may be liable under section 3505, to their ultimate prejudice. *See* 721 F.2d at 1099-1100. A similar concern has been voiced by other courts that have addressed this question. *See, e.g., United States v. American Bank & Trust*, No. 84-5624, slip op. at 4-5 (E.D. Pa. Aug. 9, 1985) (observing that "any potential burden [on the government] is outweighed by the possibility of prejudice to the lender not receiving notice"); *United States v. Associates Commercial Corp.*, 548 F. Supp. 171, 174 (N.D. Ill. 1982).

However, in light of the burden of proof placed upon the government by section 3505, we find this concern to be generally unfounded. By definition, section 3505 liability only arises if the the third party (i) has actual knowledge that the employer does not intend to or will not pay over the taxes the taxes required to be withheld, or (ii) is itself directly paying net wages. In either situation, the third party is, of necessity, actually or constructively aware of its *potential* liability for the taxes required to be deducted and withheld. Viewed in this light, the notice required by *Associates Commercial Corp.* communicates no additional information; thus, it serves no useful purpose. *Cf. United States v. Dixieline Fin.*, 594 F.2d 1311, 1312-13 (9th Cir. 1979) (holding that no independent assessment is required under section 3505(b), because it would serve no useful purpose). Quite to the contrary, construing section 6303(a) as the Seventh Circuit did simply adds an additional formalistic requirement for the imposition of sec-

tion 3505 liability—a requirement upon which parties liable under section 3505 can rely, thereby thwarting Congress' intent to recover the unpaid withholding taxes from such persons.

Although we do not intend to downplay the potential burden resulting from our construction of section 6303(a), we find the legislative history of section 3505 quite instructive on the question of prejudice to parties like Jersey Shore. When it enacted section 3505, Congress expressly considered the steps that third parties should take to protect themselves:

> [S]ureties can protect themselves against any losses attributable to withholding taxes by including this risk of liability in establishing their premiums, and lenders by their including the amounts in their loans and taking adequate security.

S. Rep. No. 1708, at 23; H.R. Rep. No. 1884, at 22. In other words, Congress envisioned a system in which third parties would take their potential liability under section 3505 into consideration at the time they entered into the transaction exposing them to liability under the statute.

Moreover, by taking steps to protect themselves at the inception of such transactions, rather than at the time the government assesses the taxes against an employer like Pennmount,

> losses now borne by the Government will fall (as it should) on the employers in the form of a larger bonding, or other fee or cost they must pay. Since the withholding taxes are, in true character, a part of the wages, it seems only appropriate that this cost be borne by the employers in the same manner as is true of the net wage costs.

S. Rep. No. 1708, at 23; H.R. Rep. No. 1884, at 22. Thus, our construction of the two statutes furthers Congress' intent with respect to section 3505, without substantially prejudicing the rights of third parties like Jersey Shore.

D.

The government also argues that requiring section 6303(a) notice for third parties subject to section 3505 liability will, in effect, render the latter statute a "dead letter," thereby thwarting Congress' intent to provide an additional source from which to recover unpaid withholding taxes. In *Associates Commercial Corp.*, the Seventh Circuit rejected this argument as "highly speculative and unsupported by any convincing statistics." 721 F.2d at 1099. We disagree; in light of the manner such taxes are collected, available statistics and common sense both dictate that such a requirement would impose a prohibitory investigative burden on the government.

First, given the number of returns involved, the government cannot be expected to initiate an investigation each time a taxpayer files a return but fails to pay his full tax liability. For example, in 1973 employers filed 2.3 million withholding tax returns with unpaid balances. McGregor & Davenport, *Collection of Delinquent Federal Taxes*, at 768. Similarly, in that same year individual taxpayers filed 3.8 million returns with unpaid liabilities. *Id.* at 601.

Second, even assuming that the resources were available, an immediate full-scale investigation in all cases involving delinquent tax payments would constitute a significant waste of government resources. Under ordinary circumstances, the problem can be dealt with more efficiently by sending the taxpayer a series of notices, as would be done by any other creditor in a similar situation. For example, in 1980 the Internal Revenue Service sent individual taxpayers 7.05 million first notices for balances due, but only 2.3 million TDA's or Taxpayer Delinquent Accounts (which result only after attempts to collect by notice fail) were issued for *all* types of returns, including individual returns. Internal Revenue Service, *Quarterly Statistical Report*, at 20-21 (Dec. 1980); *see* also McGregor & Davenport, *Collection of Delinquent Federal Taxes*, at

602-05 & n.22 (discussing TDA's). Similarly, of the 2.3 million unpaid withholding returns filed in 1973, approximately 0.8 million were paid in response to such notices, and only 1.5 million TDA's were issued. *Id.* at 768-69.

Finally, both Jersey Shore and the district court implicitly recognize this problem by suggesting that the government should delay assessing the employer-taxpayer for up to three years, thereby permitting it to identify third parties who might be liable for the taxes. This suggestion, however, would seriously jeopardize the government's interest in collecting the taxes from the employer, because such a practice would enable other creditors to obtain prior liens against the employer's property. As a result, this would seriously undermine the fundamental "purpose of the federal tax lien statute to insure prompt and certain collection of taxes due the United States from tax delinquents." *United States v. Security Trust & Saving Bank*, 340 U.S. 47, 51 (1950).

Under these circumstances, we are forced to conclude that liability under section 3505 would be rendered a substantial nullity if, as an absolute prerequisite for collection, the government is forced to give third parties such as Jersey Shore notice of its assessment against the taxpayer within sixty days.

IV.

Accordingly, the judgment of the district court will be reversed and the cause remanded to the district court for further proceedings consistent with this opinion.

WEIS, *Circuit Judge,* dissenting.

The issue in this case is not complicated—it is simply whether we read the Internal Revenue Code as Congress wrote it or as the Internal Revenue Service would like us to amend it. In clear terms, § 6303(a) states that the Secretary

of Treasury "shall, as soon as practicable, and within 60 days, after the making of an assessment of a tax pursuant to section 6203, give notice to each person liable for the unpaid tax."

The reference to "each person liable" in § 6303 is not in the least ambiguous. In the case at hand, the government contends that defendant is liable for the tax. Therefore, it seems inescapable that defendant should have been given notice.

The IRS wishes us to redraft that section so that it requires notice only to those individuals against whom taxes have been assessed. The reasons offered for this revision have some logic and would possibly ease administrative burdens on the government, but the arguments are directed to the wrong forum. They should be presented to Congress, not the courts.

In *Iselin v. United States*, 270 U.S. 245, 251 (1926), the Supreme Court said that courts should not revise a statute so that "what was omitted, presumably by inadvertence, may be included within its scope. To supply omissions transcends the judicial function."

The courts' limited role was reemphasized in *TVA v. Hill*, 437 U.S. 153 (1978). Once "Congress has spoken in the plainest of words" and "the meaning of an enactment is discerned . . . the judicial process comes to an end. We do not sit as a committee of review, nor are we vested with the power of veto." Courts may not "pre-empt congressional action by judicially decreeing what accords with 'common sense and the public weal.' Our Constitution vests such responsibilities in the political branches." *Id.* at 194-95.

In this case, I cannot even say with assurance that the addition to the statute that the IRS proposes was inadvertently omitted. Certainly, the legislative history of § 6303 provides no basis for such a belief. Moreover, the legislative history of § 3505 does not suggest that notice

should not be provided lenders who may be secondarily liable. "Congressional silence, no matter how 'clanging,' cannot override the words of the statute." *Sedima v. Imrex Co., Inc.*, 53 U.S.L.W. 5034, 5038 n.13 (June 25, 1985).

It bears mentioning that the dispute here is not about a meaningless formality. The assessment of taxes against Pennmount had the effect of enlarging the statute of limitations against defendant bank for six years. 26 U.S.C. § 6502(a)(1). *United States v. Associates Commercial Corp.*, 721 F. 2d 1094, 1097 (7th Cir. 1983). The likelihood of prejudice because of the loss or destruction of records by one secondarily liable is real and substantial. *United States v. Associates Commercial Corp.*, 548 F. Supp. 171, 174 (N.D. Ill. 1982).

The net effect of the Code revision urged by the IRS is to give less procedural protection to one secondarily liable than to the primary obligor. The notice of assessment will alert the taxpayer directly liable to the lengthened statute of limitations. He may then preserve pertinent records, arrange for payment, compromise, or take other steps in his own best interests. Without notice of the assessment, however, the party liable under § 3505 may not be alerted to his continuing exposure and concomitant risks. I am not convinced that Congress intended such an anomalous result.

Two courts of appeals have already rejected the precise arguments advanced by the government in this case. *See United States v. Merchants Nat. Bank of Mobile,* 772 F.2d 1522 (11th Cir. 1985) and *United States v. Associates Commercial Corp.*, 721 F.2d 1094 (7th Cir. 1983). I find the IRS position no more persuasive than did those courts, and I join their insistence that the government adhere to the clear mandate of the statute.

The Internal Revenue Code has never been noted for facile comprehension, and dogged plodding through it uncovers little of cheer to any taxpayer. The challenged

clause is an oasis of clarity in that desert of dull, deadly detail, but even here the IRS would pile a sandy gloss on the language to obscure the obvious. In *Temple University v. United States*, 769 F.2d 126, 139 (3d Cir. 1985), I saw "no need for the court to be unduly solicitous about curing statutory deficiencies to aid the IRS in doubtful cases." That protest applies even more here where the government's case is less meritorious.

I dissent.